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83-1443, and 83-1618

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA, et al.,
Petitioners,

VS.

TENNECO OIL COMPANY, et al.,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

JOINT SUPPLEMENTAL MEMORANDUM OF PETITIONERS PACIFIC GAS AND ELECTRIC COMPANY, SOUTHERN CALIFORNIA GAS COMPANY, AND SOUTHWEST GAS CORPORATION

THOMAS D. CLARKE
EDDIE R. ISLAND
(Counsel of Record)
GLEN J. SULLIVAN
810 S. Flower Street
Los Angeles, CA 91007
(213) 689-2078
Counsel for Petitioner Southern California Gas Company

ROBERT OHLBACH
SHIRLEY A. WOO
ROBERT B. MCLENNAN
(Counsel of Record)
77 Beale Street, 31st Floor
Post Office Box 7442
San Francisco, CA 94120
(415) 781-4211
Counsel for Petitioner Pacific Gas and Electric Company

EDWARD C. MCMURTRIE
Southwest Gas Corporation
5241 Spring Mountain Road
Post Office Box 15015
Las Vegas, Nevada 89114
Counsel for Petitioner Southwest Gas Corporation

BOWNE OF SAN FRANCISCO, INC. • 180 NINTH ST. • S.F., CA 94103 • (415) 864-2300

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Pacific Gas and Electric Company, Southern California Gas Company, and Southwest Gas Corporation ("Petitioners"), Petitioners in Cases No. *83-1443* and *83-1433*, respectively, jointly file this supplemental memorandum pursuant to the Clerk of the Court's letter of May 31, 1984, to submit their comments on the offers of settlement and settlements between certain parties to these cases.[1]

[1]Southwest Gas Corporation (Southwest) purchases gas from El Paso Natural Gas Company (El Paso) for resale in Southwest's Southern Nevada Division and Arizona Division distribution areas. Southwest also purchases gas from Northwest Pipeline Corporation (Northwest) for resale in its Northern Nevada Division distribu-

The Clerk's letter permits the parties to comment on the offer of settlement and joint request for approval of stipulation of settlement and agreement filed by Tenneco Oil Company ("Tenneco"), Conoco Inc. ("Conoco") and El Paso Natural Gas Company ("El Paso") with the Federal Energy Regulatory Commission ("FERC") on May 18, 1984.[2] Comments are also requested on other settlements between parties to these cases that might have a bearing upon the pending petitions for writs of certiorari. El Paso has entered into one other offer of settlement with Union Oil Company ("Union") involving the gas lease agreements (GLAs) at issue here.[3] [4]

Neither the Tenneco-Conoco offer of settlement nor the Union offer of settlement lessens the importance of this Court's decision on the petitions for writ of certiorari to the future cost and supply of gas from the San Juan Basin. The Tenneco-Conoco and Union offers of settlement would, if implemented, have continuing serious adverse effects on

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tion area. For that reason Southwest has joined with El Paso's two largest customers in this supplemental memorandum on behalf of its Southern Nevada and Arizona Divisions, and has also joined, on behalf of its Northern Nevada Division, in a supplemental memorandum filed by Northwest and its customers.

[2]Hereafter described as the "Tenneco-Conoco offer of settlement".

[3]Hereafter described as the "Union offer of settlement". The gas purchase contract which was negotiated by Union and El Paso as part of the Union offer of settlement was filed with the FERC on December 13, 1984. (Docket No. CI-84-141-000).

[4]Northwest has entered into settlement agreements with two of its lease holders, Phillips Petroleum Company ("Phillips") and Getty Oil Company ("Getty"). The Phillips and Getty settlements are identical to each other in all major respects. ("Northwest settlements"). There are major differences, however, between the Northwest settlements and both the Tenneco-Conoco and Union offers of settlement with El Paso. Generally, the Tenneco-Conoco and

the cost and supply of gas for Petitioners and the millions of customers they serve throughout California, Arizona and Nevada.[5] The only protection available to consumers is the regulatory power of the FERC over the offers of settlement and the underlying gas lease agreements, but the ability of the FERC to protect effectively the public interest is dependent upon this Court's decision as to whether the FERC has jurisdiction over the gas lease agreements. Unless this Court grants certiorari and reverses the decision below, the FERC's power to reject the offers of settlement will not be adequate to protect the public interest.

I

TENNECO, CONOCO, UNION AND EL PASO HAVE THE ABILITY TO WITHDRAW THE OFFERS OF SETTLEMENT

The Tenneco-Conoco and Union offers of settlement are merely offers and may be withdrawn by Tenneco, Conoco, Union and El Paso under certain conditions. The Union offer of settlement allows either Union or El Paso to walk away from the offer if satisfactory FERC approval was not obtained by April 1, 1984. FERC approval has not been given and the case is set for a prehearing conference on

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Union offers of settlement compare unfavorably from a consumer viewpoint with the Northwest settlements. PGandE and Southern California Gas Company opposed the Phillips settlement as insufficiently protective of consumer interests, but did not file comments on the Getty offer of settlement.

[5]Pacific Gas and Electric, Southern California Gas Company and Southwest Gas Corporation are not parties to either the Tenneco-Conoco or the Union offers of settlement. None of the Petitioners was involved in the negotiations for either offer of settlement. None of the Petitioners learned about the offers of settlement until Tenneco, Conoco and Union had finalized their respective offers of settlement with El Paso.

June 20. Consequently Union and El Paso are both free to withdraw their offer of settlement at any time. The Tenneco-Conoco offer of settlement may be withdrawn (a) by either side if final FERC approval in a satisfactory form has not issued in 15 months after the date of execution, (b) by Tenneco-Conoco if such final approval is not issued within 180 days following denial of certiorari in this case, and (c) by El Paso if such final approval has not issued within 30 days following the final reversal of the Fifth Circuit decision on appeal herein.

These withdrawal provisions allow Tenneco, Conoco and Union to abandon their offers of settlement if satisfactory FERC approval, based on their sole discretion, is not received within specified time periods.[4] Since the offers of settlement may be withdrawn, the Court should not deny certiorari in the belief that this case will be settled. If the petitions for certiorari are not granted, the FERC and El Paso's customers will be left with two disastrous choices: (1) accept the offers of settlement with their generous concessions to Tenneco, Conoco and Union, or (2) face withdrawal of the offers and risk further escalation of gas prices to levels far above the applicable rates under the Natural Gas Policy Act of 1978 ("NGPA") or loss of a vital gas supply. In contrast, if the petitions for certiorari are granted and FERC jurisdiction is found to exist, the FERC and El Paso's customers would not be limited to this draconian "take it or leave it" choice, but instead would

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[4]In contrast to the Tenneco-Conoco and Union offers of settlement which have not been approved by the FERC and can be withdrawn, the Phillips and Getty settlements with Northwest have been approved by FERC and cannot be withdrawn.

be able to review and question the offers of settlement with the knowledge that the FERC could order a resolution that would protect the public interest.

II

THE TENNECO, CONOCO AND UNION OFFERS OF SETTLEMENT DO NOT ALTER THE FACT THAT TREMENDOUS AMOUNTS REMAIN AT STAKE IN THIS APPEAL

A brief review of the offers of settlement confirms the fact that tremendous amounts remain at stake in this case. The offers of settlement are extremely complex and require considerable further analysis and discovery. However, by transferring the benefit of natural gas liquids to Tenneco, Conoco and Union while nominally basing the gas prices on NGPA rates, the offers of settlement continue to give Tenneco, Conoco and Union much greater economic benefits than Petitioners believe they are entitled to receive. Moreover, the offers of settlement would have a significant adverse effect on the gas supply available from the San Juan Basin to El Paso customers.

The Tenneco-Conoco offer of settlement changes the basis for the price of gas from the NGPA § 102 rate for new natural gas to the applicable maximum lawful prices for all vintages of gas except gas production from pre-1973 wells ("old gas").[7] With respect to the old gas for which the rate should be less than $1 per MMBtu, the offer of settle-

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[7]Under the Tenneco-Conoco offer of settlement, high incentive prices would be charged for NGPA § 108 stripper well gas production and NGPA § 107 gas production from tight formations. The NGPA § 108 and § 107 prices are approximately $3.97 per MMBtu and $5.80 per MMBtu, respectively.

ment sets the price at $2.00 per MMBtu, escalated for inflation through June 30, 1986.[8] After June 30, 1986, gas subject to the $2.00 price would go to the NGPA § 106(a) price which is also higher than the applicable NGPA § 104 price.[9] Similarly Union has claimed the NGPA § 109 price for gas production from pre-1973 wells which is more than $1.50 higher than the applicable old gas rate.[10] In effect, Tenneco, Conoco and Union are agreeing to NGPA maximum prices for categories of gas that are relatively expensive, but for older gas that should be much less expensive, they are seeking prices far in excess of the NGPA rates which Petitioners believe should apply.[11]

The gas prices reflected in the Tenneco, Conoco and Union offers of settlement would be implemented in new gas purchase contracts between El Paso and Tenneco, Conoco or Union. Theoretically the rates paid for the gas would

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[8]Gas from pre-1973 wells is subject to NGPA § 104 or NGPA § 106(a) pricing. The current NGPA § 104 flowing gas price is approximately $.49 per MMBtu.

[9]Currently the NGPA § 106(a) price is approximately 89¢ per MMBtu.

[10]Currently the NGPA § 109 price is approximately $2.40 per MMBtu.

[11]The gas prices stated in the Tenneco-Conoco and Union offers of settlement compare unfavorably with the Northwest settlements. In the latter agreements, no gas will be priced at the Section 107 incentive rate. Moreover, old gas from pre-1973 wells will be priced at the Section 104 replacement contract gas rate of approximately $.87 per MMBtu. If the FERC is found to have jurisdiction over the overriding royalties, however, the Northwest settlements reduce the price of gas from pre-1973 wells to the Section 104 flowing gas rate of approximately $.49 per MMBtu, provided the FERC determines that the Section 104 flowing gas rate is the appropriate ceiling price for such gas.

then be subject to the FERC's regulatory power. However, without jurisdiction over the gas lease agreements, the FERC's regulatory power would be illusory. If certiorari is denied, any action by the FERC rejecting the Section 109 rate or the $2.00 price for old gas would simply cause Tenneco, Conoco and/or Union to walk away from the offers of settlement. They would then continue collecting overriding royalties at current high levels. So the new gas purchase contracts that would be created under the offers of settlement do not lessen the need for this Court to grant the petitions for certiorari in any way.

The disposition of natural gas liquids under the Tenneco-Conoco and Union offers of settlement is extremely undesirable from the Petitioners' and gas consumers' viewpoint. The liquids removed from natural gas are quite valuable. Under the present gas lease agreements, Tenneco, Conoco and Union receive one-third of the liquids from the properties at issue, while El Paso retains two-thirds of the liquids. For many years, the revenues received from El Paso's sale of two-thirds of the liquids has been flowed through to gas consumers. Now, for the first time in the Tenneco-Conoco and Union offers of settlement, El Paso is surrendering the consumers' share of the liquids to Tenneco, Conoco and Union and depriving the consumers of their liquid credits from these properties.[12] In addition, El Paso has even agreed to give Tenneco and Conoco the consumers' share of liquids from other conventional gas purchase con-

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[12]The Tenneco-Conoco and Union offers of settlement are much worse than the Northwest settlements' treatment of liquids. Under the latter agreements, Phillips and Getty do not share in plant liquids.

tracts between El Paso and Tenneco or Conoco, even though those contracts are entirely separate from the GLA properties at issue here.

Moreover, the Tenneco-Conoco offer of settlement contemplates the construction of a new San Juan Basin cryogenic gas processing plant by Tenneco and Conoco which would strip the GLA gas and the conventional Tenneco-Conoco gas contract volumes of more liquids than are currently removed. As a result, the energy content of the gas available to El Paso's system will fall, decreasing the gas energy supply otherwise available, and increasing the liquids revenues for Tenneco and Conoco.[13] To add insult to injury, El Paso has promised to process sufficient volumes of its own gas at the new plant to ensure that the plant will operate at capacity. Tenneco and Conoco will be entitled to keep 39 percent of the liquids removed from El Paso's gas as a processing fee. This provision of the Tenneco-Conoco offer of settlement would further reduce the gas energy available to El Paso's customers while enriching Tenneco and Conoco.

Furthermore, Tenneco and Conoco have reserved the right to 25 percent of the gas production from wells drilled after 1977, while Union has reserved the right to 25 percent of the gas produced from wells drilled after deliveries commence under the new gas purchase agreement.[14] Petitioners

[13]The Northwest settlements do not contain any comparable provision adversely affecting the Btu content of the gas.

[14]Phillips and Getty in the Northwest settlements did not reserve comparable rights to retain gas. In this respect, the Northwest settlements are more favorable than the Tenneco-Conoco and Union offers of settlement.

are informed that post-1977 wells on the Tenneco and Conoco GLAs produce over half the gas coming from those properties. Consequently the amounts of gas at issue are substantial and gas consumers face a significant reduction in the gas supply available from the San Juan Basin.

The Petitioners do not know the exact value of the liquids and gas volumes at stake under the offers of settlement, but we believe that the potential amounts in question could climb into the billions of dollars. To assess the full impact of the offers of settlement will require much more analysis and discovery. The general effects of the offers' disposition of liquids and gas pricing, however, can only have tremendous long lasting adverse consequences on the price and supply of gas for consumers throughout California, Arizona and Nevada. Under the offers of settlement, even in the short term, gas consumers would pay hundreds of millions of dollars more than they would if the FERC were found to have jurisdiction. Over the longer term, the adverse impacts on consumers would climb much higher.

In this connection, it is interesting to note that Tenneco and Conoco appear willing to implement the offer of settlement even if the GLAs are nonjurisdictional, provided that a satisfactory FERC order accepting the offer of settlement is obtained. Counsel for Tenneco and Conoco has stated that under the *status quo*, their overriding royalties receipts would amount to approximately $6 billion over the next twenty years.[15] For these two companies to be willing to live with the offer of settlement in the event of nonjurisdiction suggests that Tenneco and Conoco will receive at

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[15]Quoted in the *Houston Post*, March 1, 1984, at 1F.

least as much under the offer of settlement as the *status quo* would give them. There is no reason to believe that Tenneco and Conoco will voluntarily forego revenues which are within their grasp. Instead, it appears that through the treatment of liquids and reservations of gas, Tenneco and Conoco are still exacting the same total effective cost for the GLA gas.

The Tenneco-Conoco and Union offers of settlement would also dispose of the refund issue in a manner which underscores the need for this Court to grant the petitions for certiorari. Petitioners believe that the refund liability for GLA holders in this case could amount to as much as $1 billion.[16] If implemented, the Tenneco-Conoco offer of settlement would eliminate any further inquiry into this matter by limiting Tenneco and Conoco's refund obligation to $50 million regardless of whether certiorari is granted or not. The only way the right to litigate the refund claims can be preserved is for this Court to grant the petitions for certiorari and reverse the Fifth Circuit decision. In that event, rejection of the offer of settlement would open the way for the parties to contest the refund issue before the FERC. Similarly, the refund liability of Union can only be pursued if the Court grants certiorari and overturns the Fifth Circuit decision because the Union offer of settlement makes no provision for refunds if the GLAs are not subject to the FERC's jurisdiction. Therefore it is critical to a just resolution of past issues as well as for the future for this Court to grant the petitions for certiorari.

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[16]Tenneco and Conoco's GLAs account for approximately 70% of the El Paso gas at stake. Hence Tenneco and Conoco's potential refund liability could amount to approximately $700 million.

III

THE OFFERS OF SETTLEMENT DO NOT CHANGE THE NEED FOR THIS COURT TO GRANT THE PETITIONS FOR CERTIORARI

The offers of settlement are subject to challenge and hearing before the FERC. If that process is to make a real difference, however, the administrative agency needs jurisdiction over the gas lease holders, as well as the pipeline.[17] The FERC cannot make an informed decision in the public interest on the offers of settlement unless it knows whether or not it has jurisdiction over the GLAs. Consequently, it is extremely important for the Court to grant the petitions for writ of certiorari now and decide the jurisdictional issue so the FERC will know the extent to which it can call Tenneco, Conoco and Union to account.

Petitioners have serious problems with the Tenneco-Conoco and Union offers of settlement. From our perspective, the offers of settlement would have very serious adverse, long term effects on the cost and supply of San Juan Basin gas. If certiorari is granted and the GLAs are held subject to the FERC's jurisdiction, however, the FERC will have the power to resolve this controversy and protect the public interest which is threatened by the Tenneco-Conoco and Union settlement offers.

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[17]The courts have recognized that consumers can only be protected from the price pressures of producer rate increases if the FERC has regulatory authority over the producers. *Consumer Federation of American v. FPC*, 515 F.2d 347 (D.C. Cir.), *cert. denied*, 423 U.S. 906 (1975). By the same token, the FERC needs jurisdiction over all parties, including the GLA holders, to prevent the exploitation that would occur under the offers of settlement.

For these reasons, Petitioners submit that the Tenneco-Conoco and Union offers of settlement do not lessen in any way the need for the Court to grant the petitions for writ of certiorari. As stated in the Solicitor General's reply brief, "The future ramifications of this case alone are themselves sufficiently substantial to warrant certiorari."[18] The offers of settlement do not change that fact.

Respectfully submitted,

THOMAS D. CLARKE
EDDIE R. ISLAND
(Counsel of Record)
GLEN J. SULLIVAN
810 S. Flower Street
Los Angeles, CA 91007
(213) 689-2078
Counsel for Petitioner Southern California Gas Company

ROBERT OHLBACH
SHIRLEY A. WOO
ROBERT B. MCLENNAN
(Counsel of Record)
77 Beale Street, 31st Floor
Post Office Box 7442
San Francisco, CA 94120
(415) 781-4211
Counsel for Petitioner Pacific Gas and Electric Company

EDWARD C. MCMURTRIE
Southwest Gas Corporation
5241 Spring Mountain Road
Post Office Box 15015
Las Vegas, Nevada 89114
Counsel for Petitioner Southwest Gas Corporation

[18]Reply Memorandum for Petitioner Federal Energy Regulatory Commission at 5.